

GAO

Report to the Joint Committee on  
Taxation

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TAX  
ADMINISTRATION

Gas Guzzler Tax  
Compliance Can Be  
Increased







United States  
General Accounting Office  
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General Government Division

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The Honorable Dan Rostenkowski  
Chairman, Joint Committee on Taxation

The Honorable Lloyd Bentsen  
Vice Chairman, Joint Committee  
on Taxation  
Congress of the United States

This report discusses the need for improving taxpayer compliance with the gas guzzler excise tax. The report also presents tax policy alternatives Congress may wish to consider for collecting the tax more efficiently. We made this review as part of our efforts to assess compliance with federal excise taxes and the Internal Revenue Service's enforcement strategies.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; the Commissioner of Internal Revenue; the Commissioner of Customs; and other interested parties.

*W. J. Anderson*

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Assistant Comptroller General

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# Executive Summary

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## Purpose

The federal government imposes a gas guzzler excise tax on manufacturers and importers of fuel inefficient vehicles. The tax was enacted to encourage the development, manufacture, and importation of fuel efficient cars. The tax generated \$39.8 million in fiscal year 1985 and \$147.7 million in fiscal year 1986.

GAO conducted this review to (1) measure taxpayers' compliance; (2) evaluate IRS efforts to enforce the tax; and (3) identify methods, if appropriate, for improving taxpayer compliance.

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## Background

The gas guzzler excise tax, enacted in 1978, applies to domestic and imported cars manufactured after 1979 that weigh 6,000 pounds or less and do not satisfy specified miles-per-gallon ratings. The one-time tax varies from \$200 to \$3,850 per vehicle depending on the miles-per-gallon of the vehicle and the year of manufacture.

The Internal Revenue Service (IRS) administers and enforces the tax. Manufacturers and importers are liable for the tax when they sell, lease, or use the vehicles.

With few exceptions, only certain European manufactured cars were affected by the tax during the November 1983 through November 1984 importation period GAO reviewed. This period contained the latest available data at the time of GAO's review. Other foreign imports and domestic cars were exempt based on fuel efficiency, weight, or special uses such as law enforcement. Accordingly, GAO's review focused primarily on the imported European car market.

The import market consists primarily of factory authorized importers and independent or "gray market" importers. The independent market, in contrast with the small number of factory authorized importers, consists of thousands of companies and individuals. This market has increased from about 2,400 cars in 1980 to 66,900 in 1985, according to the Department of Transportation (DOT). However, given the declining strength of the dollar in the foreign market, only 15,500 gray market vehicles entered the United States during the first half of 1986.

The Environmental Protection Agency (EPA) performs mileage tests on prototype vehicles of domestic manufacturers and factory authorized importers. EPA annually provides IRS with a listing of the vehicle makes and models that it rates as gas guzzlers. Although EPA does not perform or require these tests on all independently imported cars, IRS issued (1) a

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## Principal Findings

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### Taxpayer Noncompliance

Of the 729 independent importers GAO sampled, 723 (99 percent) were apparently delinquent in paying the gas guzzler tax on the 2,753 automobiles they imported from November 1983 through November 1984. The six compliant independent importers brought in 50 of the 2,803 vehicles included in GAO's sample. Projecting the results to the 2,458 independent importers bringing in fuel inefficient cars through the four sampled districts, GAO estimates that between \$6.0 million and \$6.4 million in taxes were not paid. (See pp. 19 and 20.)

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### IRS Actions Needed

IRS believes the primary reasons independent importers were not paying the tax, besides intentional tax evasion, were that (1) many liable importers were unaware of the tax and (2) some importers, who were aware of it, did not believe the tax had been effectuated with regard to their nonconforming vehicles. Although IRS had no program designed to advise importers of the tax, it had taken some actions to enforce the tax, including clarifying the applicability of the tax to independent importers through a revenue ruling and procedures. (See pp. 20 to 23.)

IRS' actions, however, may not reduce the gas guzzler tax noncompliance. District offices will have the discretion to decide whether and, if so, to what extent, they will establish an enforcement presence. Further, those districts that do initiate enforcement efforts may encounter difficulties because they cannot readily determine who is liable for the tax, when the tax liability is actually incurred and what amount of tax is owed. GAO believes that IRS needs to (1) identify and resolve problems the districts encounter in enforcing the tax, (2) communicate solutions and effective enforcement approaches on a Service-wide level, and (3) satisfy itself that the levels of district office enforcement efforts are appropriate. (See pp. 25 to 27.)

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## Recommendations

To promote voluntary compliance through increased taxpayer awareness, GAO recommends that the Commissioner of Internal Revenue arrange for Customs to include an explanation of the gas guzzler tax in the pamphlet Customs gives to independent importers. (See p. 28.)

To enhance the Service's efforts to improve compliance with the gas guzzler tax and assure itself that the levels of district office enforcement

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ruling to clarify the applicability of the tax to independent importers of gas guzzlers and (2) procedures for determining the amount of tax liability relating to vehicles without EPA ascribed mileage ratings.

Vehicles manufactured for the foreign market but imported through the independent market must generally be altered to meet EPA's emission and DOT's safety standards. The U.S. Customs Service advises independent importers of the EPA and DOT requirements in its pamphlet on importing a car but makes no mention of the gas guzzler tax.

To help ensure that importers bring the vehicles into conformance with U.S. standards, Customs notifies DOT and EPA that the vehicles were imported and requires the importers to post a bond. If Customs has not heard from DOT or EPA within a year after a vehicle was imported, Customs will release the importer's bond on the assumption that the vehicle has met the safety and emissions standards.

To measure compliance with the gas guzzler tax, GAO randomly sampled independent imports brought in through ports in four Customs districts from November 1983 through November 1984. According to DOT data, the four districts—Houston-Galveston, Los Angeles, New York City, and Tampa—accounted for about 80 percent of the independent imports from November 1983 through November 1984. In addition, GAO also determined whether factory authorized importers had paid gas guzzler taxes.

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## Results in Brief

GAO's sample of independent importers bringing in nonconforming vehicles through four Customs districts showed that less than 1 percent of those GAO believed were liable paid the gas guzzler tax. On the basis of its sample, GAO projects that noncompliance in those districts resulted in lost tax revenue of over \$6 million. Conversely, most of the factory authorized importers were paying the gas guzzler tax. (See p. 18.)

IRS believes that the revenue lost through noncompliance with the tax by independent importers is a problem, and has undertaken or plans a number of actions to improve compliance. Although these steps are in the right direction, GAO believes that additional IRS actions are needed because IRS' actions may not reduce noncompliance. Also, when or if IRS district offices independently decide to initiate enforcement efforts, they may encounter enforcement problems. (See p. 23.)

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efforts are appropriate, GAO recommends that the Commissioner of Internal Revenue:

- monitor district office enforcement efforts, and identify enforcement problems as well as effective enforcement approaches, and
- communicate, Service-wide, information on effective enforcement approaches and actions needed to solve identified problems. (See p. 28.)

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## Matters for Consideration by Congress

Because some additional IRS resources or a reallocation of existing resources may be needed to increase compliance with the gas guzzler tax, and because significant resources could be involved in identifying and following up with numerous importers who owe small tax amounts, GAO identified two alternatives Congress could consider for collecting the tax more efficiently. Since Customs already has involvement with independent importers, Congress could require that independent importers pay the taxes at the time of importation. (See p. 29.) Alternatively, Congress could require that Customs not release an importer's bond until the importer provides proof of the tax payment. (See p. 31.)

Although either alternative would provide for a more efficient tax collection method, each would also generate concerns by Customs and taxpayers. Both alternatives would require independent importers to pay the tax before it is presently due. If they are taxed sooner than factory authorized importers or domestic manufacturers, the issue of fairness will likely surface. Customs is not in favor of assuming the additional responsibilities under either of the alternatives. (See pp. 29 to 31.)

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## Agency Comments

IRS agreed with GAO's recommendation to develop language on the gas guzzler tax for inclusion in the pamphlet that Customs provides to independent importers. IRS also agreed with the thrust of GAO's recommendations concerning monitoring of enforcement efforts and noted that procedures are already in place to accomplish the goals suggested by GAO. IRS did not comment on the matters for Congress' consideration.

The Automobile Importers Compliance Association provided oral comments restating its position that the tax had not been effectuated with regard to independent importers and that, in any event, most of its members would not be liable for the tax. (See p. 23.) GAO requested, but did not receive, comments on a draft of this report from Treasury and Customs.

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**Abbreviations**

AICA	Automobile Importers Compliance Association
ARB	(California) Air Resources Board
DOT	Department of Transportation
EPA	Environmental Protection Agency
GAO	General Accounting Office
IRS	Internal Revenue Service

# Introduction

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The federal government imposes a gas guzzler excise tax on manufacturers and importers of automobiles manufactured after 1979 that fail to meet specified miles per gallon ratings. The tax (26 U.S.C. 4064) was enacted as part of the Energy Tax Act of 1978 to encourage the development, manufacture, and importation of fuel efficient cars. With few exceptions, only certain European manufactured vehicles were identified as gas guzzlers during the November 1983 through November 1984 importation period we reviewed, thereby subjecting the importers to the tax. Other foreign imports and domestic cars were exempt based on fuel efficiency, weight, or special uses such as law enforcement.

The Internal Revenue Service (IRS) is responsible for administering and enforcing the tax and first issued implementing regulations in 1980. IRS collected \$39.8 million and \$147.7 million in gas guzzler tax revenue during fiscal years 1985 and 1986, respectively. The increase in 1986 collections was due primarily to an increase in the tax and the introduction of additional vehicles, including domestic, that were classified as gas guzzlers.

The two major categories of imported vehicles are those

- built to meet U.S. standards and imported by original equipment manufacturers or their distributors and
- not built to meet U.S. standards and imported by independent importers.

According to the American International Automobile Dealers Association, original equipment manufacturers or their distributors—which for simplicity we will refer to as factory authorized importers—imported about 2.4 million cars in 1984 of which 530,000 were European made. Vehicles entered through the independent market (also referred to as the “gray market”) amounted to about 66,900 in 1985 as reported by the Department of Transportation (DOT)—a marked increase from the 2,400 imported in 1980. During the first half of calendar year 1986, about 15,500 vehicles entered the United States through the independent market. Industry forecasts are that, given the declining strength of the U.S. dollar in the foreign market, the downward trend will continue.

The independent market is comprised of thousands of individuals and companies that purchase foreign made cars (primarily European made) and import them into the United States for their own use, resale, or for lease. These vehicles must generally be brought into compliance with U.S. emission and safety standards.

The popularity of the independent market is due primarily to two reasons. First, the difference between the European and U.S. sales prices provides an economic incentive to the importer and the ultimate purchaser. According to a trade representative for independent importers, automobiles can be purchased overseas for substantially less than the price charged by factory authorized dealers in the United States. And, although an importer incurs expenses for transportation and altering each vehicle to satisfy U.S. emission and safety standards, importers and their customers still find the independent market economically advantageous. Second, some foreign manufactured "exotic" cars are not sold by factory authorized importers and, therefore, are only available through the independent market.

## How the Tax Is Administered

The gas guzzler tax applies to vehicles weighing 6,000 pounds gross weight or less that do not achieve minimum mileage standards. The law exempts some vehicles including certain emergency vehicles such as ambulances and hearses, and vehicles used for federal, state, and local law enforcement. The one-time tax varies from \$200 to \$3,850 per vehicle, depending on the year of manufacture and the vehicle's fuel economy. Each year through 1986 the minimum mileage standard that cars must meet to not be considered gas guzzlers has increased, as has the maximum tax applicable for each model year. A table showing the taxes by model year and miles-per-gallon ratings is presented in appendix I.

Manufacturers and importers liable for the tax are required to file their tax returns and pay the appropriate amounts to designated IRS service centers. Form 720, "Quarterly Federal Excise Tax Return" and Form 6197, "Gas Guzzler Tax" are used to file the tax. The tax liability is incurred when the vehicle is sold, leased, or used on the highway. Thus, the tax liability is not generally established at the time a vehicle is manufactured or imported.

The Energy Tax Act requires the Environmental Protection Agency (EPA) to measure the fuel economy of vehicles, to the extent practicable, in conjunction with emissions tests conducted under the Clean Air Act of 1970, as amended. EPA's emissions and fuel economy testing are conducted on prototypes submitted by domestic manufacturers and factory authorized importers. The fuel economy test results in a weighted average miles-per-gallon rating for each make and model. The weighted average is based on 55 percent urban and 45 percent highway miles-per-gallon. EPA annually reports its findings on fuel economy to IRS.

For imported vehicles not manufactured for the American market (i.e., nonconforming vehicles), EPA does not have a comparable prototype testing procedure because it considers each nonconforming vehicle to be unique. Unlike domestic and factory authorized vehicles, two otherwise identical imported nonconforming vehicles may be brought into conformance with U.S. emission standards using different procedures. In terms of fuel economy, therefore, they may differ between themselves as well as any prototype counterparts.

EPA does require that independent importers have their vehicles tested to ensure that they conform with U.S. emissions standards. However, EPA does not explicitly require independent importers to incur the additional expense of obtaining a fuel economy test for their vehicles because, according to EPA, the fuel economy test is a requirement of its certification process (i.e., testing of prototype vehicles) which independent importers are not required to meet.<sup>1</sup>

The lack of an EPA ascribed mileage rating for nonconforming vehicles caused some independent importers to believe they were not subject to the gas guzzler tax. To clarify the applicability of the tax, IRS issued in February 1986 a Revenue Ruling (Rev. Rul. 86-20, 1986-1 C.B. 319) and a Revenue Procedure (Rev. Proc. 86-9, 1986-1 C.B. 530). Basically, the revenue ruling says that the tax applies to independent importers of certain vehicles manufactured after 1979 and the revenue procedure sets forth guidelines for importers to compute gas guzzler tax liability for automobiles imported without a fuel economy rating ascribed by EPA. In January 1987, IRS issued Revenue Procedure 87-10 (Rev. Proc. 87-10, 1987-4, IRB 29 p. 29) which provided additional guidance for determining the tax liability for nonconforming vehicles. (See ch. 2 for a more detailed explanation of the ruling and procedures.)

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## Other Federal Involvement in the Independent Import Market

In addition to IRS' administration and enforcement of the gas guzzler tax, other federal agencies play a role with respect to the independent market. The U.S. Customs Service (Customs) collects the duties on imported cars and acts as an intermediary for EPA and DOT to ensure that imported nonconforming vehicles are brought into compliance with U.S. emission and safety standards. Importers are required to file with Customs DOT

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<sup>1</sup>However, EPA has drafted proposed rules which would establish a certification-based program applicable to independent importers. One of the requirements of this program would be a fuel economy test.

Form HS-7, "Importation of Motor Vehicles and Motor Vehicle Equipment Subject to Federal Motor Vehicle Safety Standards" and EPA Form 3520-1, "Importation of Motor Vehicles and Motor Vehicle Engines Subject to Federal Air Pollution Control Regulations." Customs forwards the forms to DOT and EPA, thus notifying these agencies that the nonconforming vehicles have been imported. Importers are supposed to bring their vehicles into emission and safety compliance within 90 and 120 days respectively, although extensions are allowed.

The Clean Air Act of 1970, as amended, requires that every domestically manufactured and imported motor vehicle comply with emission standards that are applicable to the model year in which the vehicle was manufactured. Domestic manufacturers and factory authorized importers are required to submit to EPA prototypes of vehicles they wish to sell in the U.S. These prototypes are tested by EPA at the Office of Mobile Sources in Ann Arbor, Michigan, to ensure that they meet the emission standards. In addition to the emission testing conducted on the prototypes, EPA also measures the urban and highway miles-per-gallon for each vehicle and calculates a combined mileage rating.

On the other hand, independent importers who import nonconforming vehicles are not required to submit prototypes for emission testing. EPA does require that nonconforming vehicles be brought into conformance with U.S. emission standards<sup>2</sup> by one of two methods, i.e., (1) conversion or (2) modification and testing. Conversion is the process of installing emission controls so that an automobile conforms in all material respects to an automobile already certified for sale in the United States. Alternatively, a vehicle can be modified by installation of emission control components and then individually tested at an EPA recognized laboratory to demonstrate emission compliance.<sup>3</sup> As part of this emissions test procedure done by the laboratory, an urban mileage rating is determined. However, the highway rating is not determined because this rating is linked to EPA's certification process which independent importers of nonconforming vehicles are not required to undergo. Therefore, unlike prototype vehicles, no combined mileage rating is normally obtained for converted or modified nonconforming vehicles unless the importer

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<sup>2</sup>EPA allows a one-time exemption from this requirement to first time individual importers of nonconforming vehicles that are at least 5 model years old. The individual importer granted this exemption cannot resell the vehicle for 2 years after importation unless it is brought into conformance with U.S. emission requirements.

<sup>3</sup>Modifiers can also submit prototype vehicles to EPA's testing center to obtain certification of their emission compliance process. After modifiers obtain certification, vehicles modified under their processes are not required to be tested for emission compliance.

chooses to arrange for and pay for the additional testing to determine the highway rating. In the case of converted vehicles, however, IRS assumes that they achieve the same combined mileage rating as a comparable prototype.

According to EPA, most independent importers use the modification and testing method to bring an automobile into compliance. EPA reviews modification and emission test results provided by the laboratory and notifies Customs if the automobile meets U.S. standards.

The National Traffic and Motor Vehicle Safety Act of 1966, as amended, (15 U.S.C. 1391 et seq.), requires that all motor vehicles manufactured for use in the United States conform to the applicable safety standards. Domestic and foreign manufacturers must certify that their vehicles meet the applicable vehicle safety standards. DOT reviews the information provided by the domestic and foreign manufacturers to substantiate conformance.

Similarly, nonconforming vehicles must satisfy all standards applicable to the vehicle's year of manufacture. For example, a 1980 car imported in 1986 must satisfy all standards in effect for the 1980 model year. When DOT receives notification from Customs that a nonconforming vehicle has been imported into the United States, it sends the importer an information package which discusses the safety requirements that must be met to bring the vehicle into conformity. DOT reviews the vehicle safety information provided by the importer to substantiate conformance and notifies Customs when the automobile has satisfied U.S. standards.

Customs requires importers to post a bond to insure that the importers bring the vehicles into conformance with U.S. emission and safety standards, and generally does not release the bond until it receives notification from DOT and EPA that (1) the vehicle conforms to U.S. standards or (2) Customs should seek the return of the vehicle for export or destruction, or it should assess penalties in cases where the vehicles do not conform to U.S. standards. If Customs has not heard from DOT or EPA within a year after the vehicle was imported, Customs will release the importer's bond on the assumption that the vehicle has met the safety and emission standards.

The manner in which EPA, DOT, and Customs carry out their respective responsibilities regarding the importation of nonconforming vehicles is

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discussed in our report entitled Auto Safety and Emissions: No Assurance That Imported Gray Market Vehicles Meet Federal Standards (GAO/RCED-87-29, Dec. 11, 1986).

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## Objectives, Scope, and Methodology

Our objectives were to (1) measure taxpayers' compliance with the gas guzzler tax, (2) evaluate IRS' efforts to enforce the tax, focusing primarily on whether all liable taxpayers were being identified and assessed, and (3) identify methods, if appropriate, to strengthen enforcement.

We focused on the imported car market because virtually all domestic vehicles were exempt from the tax based on fuel efficiency, gross weight, off-road, or special uses.

We reviewed IRS' policies, procedures, and practices for administering the gas guzzler excise tax and analyzed tax payment records. We interviewed or corresponded with officials at the following locations:

- IRS, DOT, EPA, and Customs headquarters in Washington, D.C.;
- IRS' National Computer Center in Martinsburg, West Virginia;
- IRS district offices in Houston, Texas; Los Angeles, California; Brooklyn and Manhattan, New York; Newark, New Jersey; and Jacksonville, Florida;
- Customs district offices in Houston, Texas; Los Angeles, California; New York, New York; and Tampa, Florida; and
- EPA's Office of Mobile Sources in Ann Arbor, Michigan.

To measure independent importers' compliance with the gas guzzler tax, we randomly sampled independent imports from November 1983 through November 1984 and determined if tax payments were made. The import data was the most current available at the time we started our review in September 1985. In our sample, we included independently imported cars entering the U.S. through ports in the four Customs districts with the highest volumes of independent imports: Houston-Galveston, Los Angeles, New York, and Tampa. According to DOT, these Customs districts accounted for about 80 percent of all independent imports from November 1983 through November 1984. The detailed sampling methodology is presented in appendix II.

To measure factory authorized importers' compliance with the gas guzzler tax, we determined if tax payments were made by importers of fuel inefficient vehicles for model years 1983, 1984, and 1985. We obtained from EPA a listing of fuel inefficient imported cars based on its mileage

testing of prototypes submitted by factory authorized importers. Based on EPA testing, 11 factory authorized importers brought in fuel inefficient vehicles sometime during 1983, 1984, or 1985. We then compared the names of the 11 factory authorized importers to IRS' tax payment records for the quarterly periods ending December 1983 through June 1985 to determine whether the importers paid gas guzzler taxes.

We interviewed trade representatives for independent importers and officials of factory authorized importers to obtain their views on the enforcement of the gas guzzler tax. We also contacted state vehicle registration agencies in California, Florida, New Jersey, New York, and Texas to determine whether sampled independently imported vehicles had been registered in those states. The Customs districts included in our study are located in these states.

Our review was conducted between September 1985 and May 1986, and was performed in accordance with generally accepted government auditing standards, except as noted in the following discussion of sample limitations.

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## Sample Limitations

We did not contact the importers to determine whether the conditions had been met which would subject them to the tax—that is, whether the importers had sold, leased, or used the vehicles. We did, however, contact five state vehicle registration agencies to determine if a subsample of the vehicles had been registered. Where registration information was not available, we reviewed Customs importation records to determine if the DOT and EPA requirements had been satisfied and the importers' bonds had been released indicating that the vehicles were likely to have been sold, leased, or used. As explained in detail in appendix II, 179 of the 185 vehicles in our subsample, where a determination could be made, had been registered or the importer's bond had been released. Given this and the period of time between when the vehicles were imported and when our compliance study was conducted—at least 18 months—we believe it is reasonable to assume that the vehicles would have been brought into conformance with U.S. emission and safety standards and sold, leased, or used.

Also, we took a conservative approach in estimating lost revenue associated with our gas guzzler tax compliance sample. According to IRS' revenue ruling and procedure, if an independent importer imported the same make and model as an EPA-tested and certified prototype and converted the vehicle so it conformed in all material respects to the prototype, tax



liability was based on the fuel economy rating of the certified prototype. However, according to the revenue ruling and procedure in place at the time of our review, vehicles brought into compliance using the modification and testing method were presumed to have no comparable vehicles available for establishing combined mileage ratings. In such cases, the vehicles were considered to be within the lowest fuel economy rating<sup>4</sup> thereby subjecting the importers to the maximum tax.<sup>5</sup>

Because information was not readily available and a labor-intensive review of files would have been necessary to determine whether the vehicles were converted or modified, we assumed that all imported cars that were the same make and model as EPA-tested and certified prototypes were converted and achieved the same mileage as the comparable prototype. That is, we assumed the importers were not subject to the maximum tax unless the factory authorized importer of the comparable prototype was also subject to the maximum tax.

Finally, in developing our sampling universe, we did not include importers of nonconforming vehicles if they imported the same makes and models as those tested and determined by EPA to have a mileage rating that did not subject the importer to the gas guzzler tax. However, according to IRS' revenue ruling and procedure, which was issued after we selected our sample of imports, independent importers of the vehicles we excluded may have been subject to the gas guzzler tax depending on the method used to meet U.S. emission standards.

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<sup>4</sup>Importers may elect to have their vehicles tested to establish more favorable fuel economy ratings.

<sup>5</sup>After completion of our field work, IRS issued Rev. Proc. 87-10 which explains that the independent importer is allowed to rebut the IRS presumption that there is no comparable vehicle by providing alternate evidence to the District Director. Each district has the discretion to accept or reject the evidence provided.

# IRS Should Do More to Address Noncompliance With the Gas Guzzler Excise Tax

Millions of dollars in federal revenue are not being collected due to noncompliance with the gas guzzler excise tax. Our sample of gas guzzler vehicles imported through ports in four Customs' districts from November 1983 through November 1984 showed that less than 1 percent of the independent importers paid the gas guzzler tax. Our projection of the sample results showed that between \$6.0 million and \$6.4 million in tax revenue was not collected on the vehicles entering through the four districts. On the other hand, our study of all 11 of the factory authorized importers of model year 1983, 1984, and 1985 fuel inefficient vehicles showed that 9 were paying gas guzzler taxes and 2 were not.

IRS has undertaken or plans a number of actions to improve compliance by independent importers. Although these steps are in the right direction, these actions may or may not address the noncompliance problem. District offices independently decide whether and, if so, to what extent to initiate enforcement efforts. And those that do may encounter difficulties in mounting cost effective enforcement programs primarily because data is not readily available for determining when an independent importer's tax liability is actually incurred, who is actually liable, and what amount of tax is owed. Given the above, along with the existing level of noncompliance, we believe that IRS needs to be in a position to identify what actions are or are not being taken to improve compliance and to satisfy itself that the levels of district office enforcement efforts are appropriate and enforcement issues and problems are resolved.

IRS should also take additional action to foster voluntary compliance. The independent import market is comprised of thousands of individuals and companies. IRS believes that many of these importers are unaware of the gas guzzler tax, but it currently has no program aimed at increasing taxpayer awareness.

## Most Factory Authorized Importers Do Not Appear to Pose a Compliance Problem

Compliance with the gas guzzler tax by factory authorized importers is considerably higher than compliance by independent importers. Our compliance study showed that 9 of the 11 importers of model year 1983, 1984, and 1985 fuel inefficient cars had paid gas guzzler taxes.<sup>1</sup> We could not find tax payment records for the other two factory authorized importers.

<sup>1</sup>We did not determine whether the nine importers had paid the appropriate amount of tax. To do so would have required us to contact the companies and review their books and records relating to the sale of specific vehicles.

To measure compliance with the tax, we first obtained EPA listings of imported fuel inefficient vehicles for model years 1983 through 1985. The listings were compiled by EPA based upon its testing of prototypes submitted by factory authorized importers. Using the EPA listings, we identified the 11 factory authorized importers subject to the tax. Not all of the 11 were liable for the tax for all tax periods reviewed. Our analysis of the EPA listing showed that (1) some importers brought in fuel inefficient vehicles in some years but not others; and (2) one importer brought in fuel inefficient vehicles for only part of 1 year.

After identifying the 11 factory authorized importers liable for the tax, based on EPA prototype testing, we then reviewed IRS' tax payment records for the quarterly tax period ending December 1983 through the period ending June 1985 to determine whether the factory authorized importers had paid gas guzzler taxes. Table 2.1 shows the gas guzzler taxes paid by the factory authorized importers for the quarterly period ending December 1983 through the period ending June 1985.

**Table 2.1: Gas Guzzler Excise Tax  
Payments by Factory Authorized  
Importers**

Quarterly tax period ending	Number of factory authorized importers filing returns	Amount paid
December 1983	6	\$2,194,450
March 1984	6	2,777,300
June 1984	7	3,177,250
September 1984	7	4,374,600
December 1984	9	12,182,800
March 1985	7	11,243,200
June 1985	7	11,381,650

## Few Independent Importers Are Paying the Gas Guzzler Tax

Our sample of independent importers showed that less than 1 percent had paid the gas guzzler tax. Of the 729 sampled importers that brought in 2,803 fuel inefficient vehicles through four Customs' districts from November 1983 through November 1984, 723 that imported 2,753 vehicles were apparently delinquent in paying the tax. Table 2.2 shows the results of our compliance sample.

**Table 2.2: Compliance by Sampled Independent Importers**

Custom districts	Number of independent importers	Number of importers sampled	Sampled importers	
			Compliant <sup>a</sup>	Apparently delinquent
Houston-Galveston	585	209	0	209
Los Angeles	1,075	223	4	219
New York	605	186	2	184
Tampa	193	111	0	111
<b>Totals</b>	<b>2,458</b>	<b>729</b>	<b>6</b>	<b>723</b>

<sup>a</sup>We assumed an importer to be compliant if a return was filed and any amount of tax was remitted (see sampling methodology in app. II).

We did not contact the importers to verify that they had in fact sold, leased, or used the imported vehicles and thereby incurred the tax liability. However, as explained in greater detail in appendix II, we followed up on a sample of 142 of the 723 apparently delinquent importers and found indications that most were liable for the tax.

Assuming the 723 importers who did not pay were liable for the tax, we estimate that the government lost about \$3.6 million in gas guzzler tax revenue. Projecting the sample results to the total number of independent importers using the ports in the four Customs districts during the same time period, we estimate that the government lost between \$6.0 million and \$6.4 million in gas guzzler tax revenue. These four ports accounted for about 80 percent of the independent imports from November 1983 through November 1984. Due to our sampling methodology, we cannot statistically project our results to the Customs districts that were not included in our study.

## Why Are Liable Independent Importers Not Paying the Gas Guzzler Tax?

Our study indicates two possible reasons why independent importers were not paying the tax. First, according to IRS, besides intentional tax evasion, most independent importers are individuals and small companies, and may therefore be unaware of the tax. Second, some independent importers who were aware of the tax did not pay because they did not believe the tax applied to them.

## Independent Importers May Not Be Aware of the Tax

Many liable independent importers may be unaware of the gas guzzler tax filing requirement and therefore do not pay. IRS officials believe this to be a reason for noncompliance with the tax, pointing out that a large number of the vehicle importers are individuals and small companies who are less likely to be familiar with excise tax filing requirements. We

agree and believe that informing importers of their potential liability would help foster better voluntary compliance with the tax.

Although IRS believes that many liable importers are unaware of the gas guzzler tax and therefore do not pay, it has no program specifically designed to increase taxpayer awareness. We believe a practical and effective way to advise importers of their liability would be to arrange for Customs to provide importers with information on the gas guzzler tax. Customs has direct contact with all independent importers and generally provides them with a pamphlet entitled, "Importing a Car" (Customs Publication 520). The pamphlet explains the DOT and EPA requirements importers must satisfy but does not mention the gas guzzler tax. Customs officials told us they would be willing to assist IRS by providing an advisory notice about the gas guzzler tax as long as the notice referred importers to IRS for any questions or clarification.

During fiscal year 1987 Senate Appropriations Committee Hearings, the Commissioner of Internal Revenue was asked why IRS had not requested Customs' assistance in notifying independent importers of the gas guzzler tax. The Commissioner said that IRS had not requested Customs' assistance because "only a small portion of the total number of importers would potentially be subject to the gas guzzler excise tax. . . ." While it may be true that only a small portion of all importers would be liable for the tax, an advisory notice need not be given to all importers. Rather, we believe the notice could be directed at independent importers by including the notice in the information pamphlet Customs gives to prospective importers of nonconforming vehicles.

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### Some Independent Importers Believed the Tax Law Was Not Effectuated

According to industry and some IRS officials, many independent importers were not paying the tax because they did not believe that it applied to them. This belief was articulated by the Automobile Importers Compliance Association (AICA) in petitions to IRS stating that the tax law had not been effectuated with regard to independent importers. AICA members are involved in the importation, modification, and testing of independently imported cars. Recently, however, AICA's Executive Director said that in view of the expense associated with further challenges, and discussions with IRS which indicate that in most cases the tax burden would not be borne by the AICA member, AICA is not considering further actions on behalf of its members.

On March 21, 1985, the AICA submitted a petition to IRS stating that the gas guzzler tax, with regard to independent importers, had not been

effectuated and, therefore, no basis existed for assessing the tax. AICA maintained that IRS' 1980 regulations implementing the tax made no provision for determining tax liability for independent importers. Instead, the regulations addressed calculating tax liability based on EPA prototype testing. Further, AICA maintained that because combined mileage ratings are needed to determine tax liability but are not developed by EPA for nonconforming vehicles, the tax should not apply.

IRS issued Revenue Ruling 86-20 and Revenue Procedure 86-9, dated February 18, 1986, to clarify the applicability of the gas guzzler tax to independent importers. Shortly thereafter, on March 18, 1986, IRS responded to AICA's petition saying the Service did not agree with AICA's position and referred AICA to its recently issued ruling and procedure for calculating tax liability. The ruling says that an importer who brings in an automobile without a fuel economy rating assigned by the EPA is nevertheless subject to the gas guzzler tax. It also says that "it would be impractical ... for EPA to ascribe a fuel economy rating to all imported nonconforming automobiles. . . ."

On May 12, 1986, AICA again petitioned IRS and requested a reevaluation of Revenue Ruling 86-20. AICA further requested that IRS apply the tax liability prospectively rather than retroactively.

After AICA submitted its petition to IRS, other actions took place which could have a bearing on IRS' efforts to enforce the tax on independent importers. First, in the report accompanying IRS' Fiscal Year 1987 Continuing Appropriations Resolution, House Joint Resolution 738, the House and Senate conferees expressed a belief that IRS should examine the cost-effectiveness of any effort to collect the gas guzzler tax retroactively. Second, on July 28, 1986, and October 31, 1986, Senator Rudman wrote to IRS expressing concerns about whether the gas guzzler tax has been fully implemented in the case of independent importers and whether it would be cost-effective for IRS to retroactively collect the tax.

On December 29, 1986, IRS formally responded to both Senator Rudman's letters and AICA's second petition saying that independent importers are subject to the tax and that the tax would be assessed retroactively. In the letter to Senator Rudman, IRS also said that his concerns about the cost-effectiveness of retroactive collections had been forwarded to the Examination Division for appropriate actions.

In April 1987, we received oral comments from AICA's Executive Director on portions of a draft of this report. In addition to clarifying our understanding of AICA's position as outlined above, we discussed AICA's plans in view of IRS' denial of the latest petition. According to the Executive Director, no further actions are planned on behalf of the membership because it would be too expensive to pursue the matter any further. Also, the Executive Director believes that AICA members will not be liable for the gas guzzler tax on most of their independent imports. He said discussions with IRS suggest that the person who caused a vehicle to be imported is the one who is liable for the tax. Therefore, if the independent importer brought in a fuel inefficient vehicle at the request of a client, then the client is actually the importer and liable for the tax. According to the Executive Director, this type of situation accounts for about 75 percent of the AICA member dealers' transactions.

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## IRS Needs to Reinforce Its Compliance Efforts

IRS believes that the gas guzzler tax compliance rate by independent importers is unacceptable and has actions both underway and planned to address the noncompliance problem. To clarify the applicability of the gas guzzler tax to independent importers, IRS issued a revenue ruling and procedure. IRS also obtained data on independent importers of fuel inefficient vehicles for use in identifying noncompliant taxpayers and provided training to personnel responsible for enforcing the tax.

The extent to which IRS' actions will improve compliance depends on the district offices' decisions on whether, and to what extent, to establish an enforcement presence. Each district office has the discretion to decide on the level of effort, if any, to devote to enforcement of the gas guzzler tax. Further, if district offices do undertake enforcement initiatives, they may encounter difficulties in determining who is liable for the tax, when the tax liability is actually incurred, and what amount of tax is owed because information on emission conversion or modification is not always readily apparent. Accordingly, we believe that IRS needs to satisfy itself that district office enforcement decisions are appropriate, that problem areas are being identified, and that solutions are devised and, along with information on effective enforcement approaches, are communicated on a Service-wide level.

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## IRS Actions to Address Noncompliance

On February 18, 1986, IRS issued Revenue Ruling 86-20 and Revenue Procedure 86-9 to clarify applicability of the gas guzzler tax to independent importers. The ruling affirmed that the tax applies to independent

importers of new and used vehicles and the procedure provided the guidelines for determining the tax amount.

According to the ruling, the key to determining whether an independent importer is liable for the gas guzzler tax on an imported nonconforming vehicle and, at what amount, is dependent on the method used by the importer to bring the vehicle into conformance with emission standards. As discussed on pages 13 and 14, independent importers can use one of two available methods for meeting emission requirements, i.e., conversion or modifying and testing.

If the importer uses the conversion method—installing emission controls so that the vehicle conforms in all material respects to a vehicle already certified for sale in the U.S.—the fuel economy rating is considered to be equal to the EPA ascribed rating for the factory authorized importer's prototype. Importers that use the modifying and testing option are liable for the maximum tax amount for the applicable model year unless they can provide documentation to the contrary which is acceptable to IRS. According to Revenue Procedure 86-9, importers could have their vehicles tested at their own expense and provide IRS with acceptable urban and highway mileage test data to establish a more favorable combined fuel economy rating and lower tax.

In January 1987, IRS issued Revenue Procedure 87-10 which expanded on the importers' ability to challenge IRS' presumption of lowest fuel economy and maximum tax liability. As an alternative to the individual testing of vehicles, an importer may rebut the presumption of low fuel economy and maximum tax liability by using the EPA-recognized laboratory test results of a vehicle of the same year, make, model, and engine that the importer has had modified in the same manner as the vehicle in question. Documentation supporting the fuel economy rating must be retained for a period of 3 years from the date the tax becomes due or the tax is paid, whichever is later. In addition, the IRS District Directors can accept any other fuel economy rating, which to their satisfaction, is supported by sufficient documentation.

IRS has also taken steps to identify potentially liable importers. In a December 27, 1985, letter to DOT, IRS requested data identifying importers of nonconforming vehicles. According to the letter, the information was needed "to encourage voluntary compliance (with the gas guzzler tax) and protect the revenues of the Government. . . ." DOT maintains a computerized data base on imported nonconforming vehicles as part of its program to ensure that such vehicles are brought into compliance



with U.S. safety standards. The data base includes the importer's identity (name, address, and importer number), vehicle identification data (year, make, model, and serial number), and Customs import data (entry number, port of entry, and date of entry) and is therefore useful in identifying which vehicles may be gas guzzlers. The source for the information in the data base is the DOT Form HS-7 that is filed by the importer with Customs and forwarded to DOT.

According to IRS, it has received the DOT data identifying nonconforming imported cars entering the U.S. from 1982 through 1985. IRS has sorted the data by IRS district and plans to send the listings of importers and the nonconforming vehicles they imported to the respective IRS district offices for their use in identifying gas guzzler vehicles and in deciding whether to pursue compliance projects. Depending on the DOT data's usefulness in identifying nonfilers, IRS may arrange to obtain it on a recurring basis.

To educate its excise tax specialists and managers on recent excise tax developments, IRS provided a 1-week training course, in September 1986, for personnel involved in identifying and reducing excise tax noncompliance. Included as part of the training package was a section on the gas guzzler excise tax. The gas guzzler section presented an overview of the tax and discussed the revenue ruling and the initial procedure issued to clarify the applicability of the tax to independent importers. The training materials also pointed out problems being encountered such as identifying the vehicles which may subject the importer to the tax and identifying who the importer is. Certain examination techniques that could be used to enforce the tax were also included as part of the course. As discussed below IRS districts will continue to face issues, such as determining who the importer is, when the tax is due, and what amount is owed.

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### IRS Should Monitor and Evaluate District Offices' Enforcement Decisions and Approaches

Although IRS' past and planned actions to improve compliance are noteworthy, noncompliance may not be reduced to any substantial degree. District offices independently decide whether and, if so, to what extent they will mount enforcement efforts. Thus, it is conceivable that district offices, when making resource allocation decisions, may opt not to initiate any gas guzzler tax compliance projects. And, those that do may find it difficult to devise cost-effective approaches because it is not always readily apparent who is liable for the tax, when the liability is actually incurred, and what amount is owed. In addition, IRS acknowledges that

its limited contacts thus far with noncompliant independent importers have met with some resistance and claims of taxpayer harassment.

We recognize that district offices need flexibility in making resource allocation decisions and that the potential revenues to be gained versus the costs to implement compliance efforts need to be considered when making such decisions. At the same time, however, we are concerned from an equity standpoint that a segment of the taxpayer population, known to be potentially delinquent, may receive no enforcement attention. IRS' National Office should be in a position to identify what actions are or are not being taken to improve compliance and satisfy itself that the levels of district office enforcement efforts are appropriate.

IRS also needs a system for monitoring district offices that do initiate compliance projects and communicating, Service-wide, information on problem identification and resolution and effective enforcement approaches. District offices that initiate compliance projects are likely to encounter a number of enforcement problems. Some independent importers may claim that they are agents for their customers and their customers therefore are actually the importers who are liable for the tax. Further, information is not readily available as to when imported vehicles were sold, leased, or used for purposes of IRS determining when the tax liability is incurred by those who do not voluntarily comply. And finally, to administer the tax in a fair and consistent manner district offices may need to develop guidance for implementing the recent revenue procedure allowing importers to contest IRS' presumption of lowest fuel economy and assessment of the maximum tax for certain nonconforming vehicles.

Through its revenue ruling, IRS has affirmed that independent importers are liable for the gas guzzler tax. The question of who is actually the importer is less clear and, according to IRS, the facts of each case must be weighed and examined to determine who is the importer. Nevertheless, the past controversy and claims of taxpayer harassment may intensify if district offices vary significantly in their enforcement approaches.

Determining when the tax liability is actually incurred poses difficulties of another kind. The DOT listings that will be distributed to district offices are useful only in establishing an importer's potential tax liability. An importer is not liable for the tax until a gas guzzler vehicle is sold, leased, or used—an event that usually occurs after a vehicle is imported. Customs data indicating that a vehicle has been released from

bond will generally establish that the taxable event is imminent, or perhaps has already occurred, but it too is not necessarily definitive. Accordingly, IRS will need to develop an approach such as contacting the importers or state vehicle registration agencies to determine when gas guzzler vehicles have been sold, leased, or used, thereby subjecting the importer to the tax.

Through Revenue Procedure 87-10, issued in January 1987, IRS provided independent importers with alternatives to rebut an IRS presumption of lowest fuel economy and assessment of the maximum tax. At the same time, district directors were given wide latitude under the new procedure to decide what documentation importers can submit to support claims that they owe a lower tax amount. Thus, IRS districts could conceivably reach different conclusions regarding the tax amounts to be assessed on vehicles of the same year, make, and model. Conversely, district offices could reach the same conclusions regarding the tax amount to be assessed on vehicles that are not comparable. Such cases could result in inconsistent treatment of independent importers and raise questions about IRS' fairness in assessing the tax.

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## Conclusions

Millions of dollars of federal revenue are being lost through independent importers' noncompliance with the gas guzzler tax. Over 99 percent of the independent importers in our sample had not paid the gas guzzler tax. Our projection of the sample results showed that between \$6.0 million and \$6.4 million in tax revenue was not collected on the vehicles entering through the four districts.

IRS has actions underway or planned to improve compliance with the gas guzzler tax. We believe, however, that IRS should take additional action to promote voluntary compliance and it should oversee and evaluate the district offices' decisions on whether and how to enforce the tax. By arranging for Customs to include information on the gas guzzler tax in the pamphlet it provides to independent importers, IRS can increase taxpayer awareness and thereby promote voluntary compliance. By overseeing and evaluating district office decisions, IRS can (1) identify and resolve problems district offices encounter in enforcing the tax, (2) communicate on a Service-wide level solutions to these problems as well as effective enforcement approaches, and (3) assure itself that the levels of district office enforcement efforts are appropriate.

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## Recommendations

To promote voluntary compliance through increased taxpayer awareness, we recommend that the Commissioner of Internal Revenue arrange for Customs to include information on the gas guzzler tax in the pamphlet it provides to independent importers.

To enhance the Service's efforts to improve compliance with the gas guzzler tax and assure itself that the levels of district office enforcement efforts are appropriate, we also recommend that the Commissioner of Internal Revenue

- monitor district office enforcement efforts and identify enforcement problems as well as effective enforcement approaches; and
- communicate, Service-wide, information on effective enforcement approaches and actions needed to solve identified problems.

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## Agency Comments and Our Evaluation

The Commissioner of Internal Revenue, in commenting on a draft of this report (see app. III), agreed with our recommendation to include information on the gas guzzler tax in the pamphlet Customs provides to independent importers. He also agreed with the thrust of our recommendations concerning the monitoring of district office enforcement efforts and indicated that procedures for monitoring and communicating information to districts are in place.

The Commissioner highlighted various monitoring and information dissemination activities which can be useful in implementing our recommendations for improving compliance and assuring that district office enforcement efforts are appropriate. These activities include (1) monitoring of district office enforcement efforts by the districts, regions, and National Office using information collected through the Automated Management Information System; (2) monitoring by the National Office of locally initiated projects; (3) distributing information on areas of nationwide or local noncompliance to all districts when it is obtained; and (4) obtaining information from other government agencies and distributing it to districts to help them more effectively identify and reduce noncompliance. To the extent that these activities are focused on the issues we addressed and produce fair and consistent treatment of taxpayers, the Commissioner's comments are responsive to our recommendations.

We requested, but did not receive, comments on a draft of our report from the Department of the Treasury and Customs.